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MONTANA LOTTERY

FINANCIAL STATEMENTS
(UNAUDITED)

PERIODS ENDED SEPTEMBER 30 AND JUNE 30, 1987

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TABLE OF CONTENTS

	Page
Appointive Officials	iii
Report Distribution	iv
Transmittal Letter	1
Balance Sheet	3
Statement of Revenues, Expenses and Changes in Retained Earnings	4
Notes to the Financial Statements	5
Summary of Financial Activity by Percentage	10

APPOINTIVE OFFICIALS

Diana S. Dowling, Lottery Director

L. John Onstad, Lottery Assistant Director for Security

LOTTERY COMMISSION

Spencer Hegstad, Chairman	Dillon
Pat DeVries	Polson
Glenn Osborne	Great Falls
Jim Moore	Bozeman
Keith Colbo	Helena

LOTTERY LIAISON COMMITTEE

Senator Larry Tveit	Fairview
Senator Larry Stimatz	Butte
Representative Budd Gould	Missoula
Representative John Vincent	Bozeman

REPORT DISTRIBUTION

According to Section 23-5-1007(7), MCA, copies of this report must be distributed to the following individuals.

Ted Schwinden, Governor

Ellen Feaver, Director, Department of Administration

Scott Seacat, Legislative Auditor

Bill Norman, President of the Senate

Robert L. Marks, Speaker of the House

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature". The President of the Senate and the Speaker of the House requested this report be distributed to the Revenue Oversight Committee. Members of the Revenue Oversight Committee include:

Senators	Representatives
Robert Brown	Dan Harrington
Bruce Crippen	Gerry Devlin
Dorothy Eck	John Harp
Thomas Hager	Nancy Keenan
Joe Mazurek	Jack Ramirez
Bill Norman	Mel Williams

In addition, the Speaker of the House requested this report be distributed to the House Business and Labor Committee. The House Business and Labor Committee members include:

Representatives

Fred Thomas	Bob Bachini
Ray Brandewie	Jan Brown
Ben Cohen	Jerry Driscoll
William Glaser	Larry Grinde
Stella Jean Hansen	Tom L. Jones
Lloyd "Mac" McCormick	Thomas Nelson
Jerry Nisbet	Bob Pavlovich
Bruce Simon	Clyde Smith
Charles Swysgood	Norm Wallin

Lottery
Montana

Ted Schwinden
Governor

Diana S. Dowling
Director

Gerald J. LaChere
Operations
Nancy L. Goodspeed
Marketing
L. John Onstad
Security

2525 N. Montana
Helena, MT 59601-0542
(406) 444-LUCK

January 28, 1988

To the Montana Lottery Commission:

In accordance with Section 23-5-1007, Montana Code Annotated, I am pleased to transmit the unaudited financial statements for the periods ended September 30 and June 30, 1987.

These financial statements reflect activity for the Montana Lottery from inception through June 30, 1987 and for the quarter ended September 30, 1987. Because of the costs associated with the Lottery start-up and initial ticket sales, the financial activity for the periods ended September 30 and June 30, 1987 is not comparable.

HISTORICAL PERSPECTIVE

The Montana Lottery was created in November 1986 by an overwhelming majority referendum vote of the people of Montana. With a July 1, 1987, mandate for the Lottery start-up, much needed to be accomplished in establishing a multimillion dollar business within eight short months -- lease a building; sign contracts; purchase office furniture, vehicles, and computers; install security systems; write job descriptions for, hire and train a staff of 35 employees; buy over 30 million lottery tickets; and license approximately 1,000 enthusiastic retailers. Having met the challenge, Montana's first lottery tickets "Pot of Gold" went on sale for the first time on June 24, 1987, seven days before the July 1 legislative mandated start date.

FINANCIAL HIGHLIGHTS

Opening day sales resulted in the Montana Lottery setting a national record! As evidenced by the financial statements, revenue from lottery ticket sales totaled over $4.7 million for the period ended June 30, 1987 and over $7 million for the quarter ended September 30, 1987. For these combined periods,

Montana Lottery Commission Members

Spencer Hegstad, Chairman	Keith Colbo	Pat DeVries	Jim Moore	Glenn Osborne
Dillon	Helena	Polson	Bozeman	Great Falls

Montana lottery retailers received commissions amounting to $656,000, while winners were paid over $3.4 million in prizes. In addition, Montana employees, advertisers, businesses, and other government entities have benefited by providing their goods and services to the Lottery.

Because of the Lottery's initial success, over $3.8 million will be transferred to the state Superintendent of Public Instruction. These funds, distributed to eligible counties as equalization aid for the retirement funds, provide tax relief for Montana's property taxpayers.

CONCLUSION

As indicated by the financial highlights above, Montana's Lottery has already created many winners ----- thanks to the players, retailers, consultants, state government employees, and the staff of the Montana Lottery.

Sincerely,

Diana S. Dowling

Diana S. Dowling
Director

MONTANA LOTTERY
BALANCE SHEET
SEPTEMBER 30, 1987 AND JUNE 30, 1987

	September 30, 1987 (Unaudited)	June 30, 1987 (Unaudited)
ASSETS		
Cash and Cash Equivalents	$4,860,928	$ 196,046
Receivables (Net)	285,993	3,418,025
Due from Other Funds		280
Inventories	398,864	379,458
Equipment	707,332	675,376
Other Fixed Assets	4,093	4,093
Accumulated Depreciation	(45,074)	(18,800)
Intangible Assets	798,380	840,400
Other Assets	11,810	8,571
TOTAL ASSETS	$7,022,326	$5,503,449
LIABILITIES AND FUND EQUITY		
Liabilities:		
Accounts Payable and Accruals	$ 463,979	$1,003,879
Lottery Prizes Payable	1,869,209	1,093,651
Interfund Loans Payable		1,230,000
Due to Other Funds	3,824,330	91,864
Installment Purchase Payable	817,055	817,055
Compensated Absences Payable	47,753	31,316
Total Liabilities	$7,022,326	$4,267,765
FUND EQUITY:		
Residual Equity Transfers	$ 0	$ (30,199)
Retained Earnings Unreserved	0	1,265,883
Total Fund Equity	0	1,235,684
TOTAL LIABILITIES AND FUND EQUITY	$7,022,326	$5,503,449

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
PERIODS ENDED SEPTEMBER 30, 1987 AND JUNE 30, 1987

	September 30, 1987 (Unaudited)	June 30, 1987 (Unaudited)
OPERATING REVENUES:		
Charges for Service		
Gross lottery ticket sales	$7,857,051	$5,264,578
Less free tickets distributed	(785,705)	(526,458)
Net lottery ticket revenue	7,071,346	4,738,120
License and permits	3,100	54,900
Total Operating Revenues	7,074,446	4,793,020
Prizes and Commissions		
Prize expense	(3,184,227)	(2,133,575)
Retailer commission	(392,852)	(263,229)
Net Operating Revenue	$3,497,367	$2,396,216
OPERATING EXPENSES:		
Amortization	$ 42,020	$
Personal Services	254,001	193,746
Contractual Services	236,375	562,974
Cost of tickets sold	153,554	102,713
Audit Fees	8,573	7,338
Supplies and Materials	20,335	35,596
Depreciation	26,274	18,800
Utilities and Rent	26,501	30,265
Communications	32,411	19,649
Advertising	35,271	81,281
Travel	13,181	25,785
Repairs and Maintenance	17,091	21,633
Management Service Fee	15,264	15,842
Other	8,289	2,295
Total Operating Expense	$ 889,140	$1,117,917
Operating Income	$2,608,227	$1,278,299
NONOPERATING REVENUES (EXPENSES)		
Interest expense	(17,645)	(12,416)
Total Nonoperating Revenues (Expenses)	(17,645)	(12,416)
Income before Operating Transfers	2,590,582	1,265,883
Operating Transfers In (Out)	(3,824,234)	0
NET INCOME (LOSS)	$(1,233,652)	$1,265,883
Retained Earnings, Beginning of Period	$1,235,684	0
Prior Period Adjustments	(2,032)	
Retained Earnings, Beginning of Period as Restated	1,233,652	
Residual Equity Transfer		(30,199)
RETAINED EARNINGS, END OF PERIOD	$ 0	$1,235,684

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
Notes to the Financial Statements (Unaudited)
September 30 and June 30, 1987

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Montana Lottery, established under the provisions of Section 23-5-1001, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets were sold on June 24, 1987.

These financial statements reflect activity for the Montana Lottery from inception through June 30, 1987, and for the quarter ended September 30, 1987. Because of the costs associated with the Lottery start-up and initial ticket sales, the financial activity for the periods ended September 30 and June 30, 1987 is not comparable.

The Montana Lottery's financial statements are prepared in accordance with generally accepted accounting principles on the accrual basis of accounting. A summary of the more significant accounting policies follow:

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the governmental Proprietary Fund Type. Enterprise Funds account for operations a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or (b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Revenue Recognition. Lottery ticket sales are recorded as revenue based on ticket deliveries to the retailers. Because no historical perspective exists as of September 30, 1987, no reserve for estimated ticket returns has been established.

Free Tickets. The Montana Lottery's instant games award free tickets as prizes. The retail value of free tickets awarded is included in gross lottery ticket sales. The value of the free tickets distributed is reflected as a reduction of revenue rather than a prize expense.

Prizes. Expenses for instant prizes are recorded based on the predetermined prize structure for each game.

Commissions. Retailers receive a five percent commission on tickets or chances sold. Commission expense is recorded

based on ticket deliveries to the retailers.

Amortization. The Instant Lottery System (ILS) software, classified as an intangible asset, is being amortized over a period of five years using the straight line method.

Receivables. Receivables represent amounts owing the Lottery for purchased tickets. An allowance for doubtful accounts has not been established because no uncollectible accounts existed at the end of the financial reporting periods.

Equipment and Other Fixed Assets. Equipment and other fixed assets are recorded at cost. Depreciation is calculated using the straight-line method over estimated lives of four to ten years.

Inventories. Inventories consist of lottery tickets stored in the warehouse and with the field representatives. These ticket inventories are recorded at cost and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold when sold. Upon disposal, unsold tickets are charged to cost of tickets sold.

2. APPROPRIATIONS AND REVENUE ESTIMATES

The fiscal year 1987-1988 and 1986-1987 appropriations and revenue estimates are detailed as follows:

	1987-1988	1986-1987
Revenue estimates		
Ticket sales	$25,000,000	$4,500,000
Licenses	60,000	40,000
Appropriations		
Operations	3,677,244	718,892
Audit	74,256	
Start-up		1,500,000
Commissions	1,370,500	263,229
Prizes	11,254,500	2,133,575
Transfers	8,633,500	

3. INTERFUND LOANS PAYABLE

Section 24, Chapter 669, Laws of 1985, provides for a temporary line of credit of $1,500,000 from the General Fund for starting the Lottery. The law states that the loan must be repaid at 10% interest within one year of the advance.

With the first advance dated December 18, 1986, the loan was repaid on August 19, 1987, with $30,061 in interest.

4. PRIOR PERIOD ADJUSTMENTS

The prior period adjustments of $2,032 reflect expense activity from the previous year recorded in the current period.

5. GAMES

Currently, the Montana Lottery games are an instant ticket game. This game provides the players the opportunity to win instantly by scratching the ticket's latex covering to reveal the prize. Players also have another chance to win by submitting five non-winning tickets for the Big Spin drawing.

6. PAID PRIZES

Section 23-5-1027 MCA states "as near as possible to 45% of the money paid for tickets or chances must be paid as prize money". Since June 24, prizes paid are detailed as follows:

High-tier	$ 806,700
Low-tier	2,361,893
Big Spin	280,000
	$3,448,593

High-tier prizes reflect prizes of $100, $1,000 and $10,000 paid through Lottery headquarters. Low-tier prizes of $2 and $5 are paid by the retailer or Lottery headquarters. Free ticket prizes of $1,312,163 are reflected as a revenue reduction rather than a prize expense.

7. TRANSFER TO STATE SUPERINTENDENT OF PUBLIC INSTRUCTION.

Section 23-5-1027, MCA states for "that part of all gross revenue not used for payment of prizes, commissions, and operating expenses is net revenue and must be paid quarterly from the enterprise fund to the state Superintendent of Public Instruction for distribution as equalization aid to the retirement funds..."

The transfer of $3,824,234 reflects the net income for the periods ended September 30 and June 30, 1987. The Lottery was exempted from making a transfer for the quarter ended June 30, 1987 until the general fund start-up loan had been repaid.

The account "Due to Other Funds" includes the $3,824,234 payable to the state Superintendent of Public Instruction.

8. RESIDUAL EQUITY TRANSFER.

The residual equity transfer represents $30,199 transferred to the Department of Administration, Telecommunications Bureau, for the Lottery telephone system.

9. GAMING SUPPLIER CONTRACTS

Tickets. On March 9, 1987, the Montana Lottery signed a one year contract with Scientific Games, Inc. to purchase lottery tickets. Each instant ticket game consists of 4,800,000 tickets or other quantity as agreed by the parties. This contract may be extended for two additional one year contracts.

The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure. The contract requires payment within 30 days of ticket receipt.

Scientific Games, Inc., as the vendor, delivered a $776,104 performance bond covering the contract term. The Company also provided an errors and omissions policy covering an ultimate net loss of $5,000,000.

This contract may be terminated when termination is in the best interest of the Lottery with proper notification to Scientific Games, Inc.

Computer Hardware and Software. The Lottery contracted with the Scientific Games, Inc. on February 25, 1987, to purchase a used Stratus computer. The computer hardware and software cost $381,243. This contract also covered the acquisition of an Unlimited Power Supply (UPS) system for $40,551. The UPS system protects the computer against electrical power surges and failures.

The Lottery signed a separate agreement with Stratus Computer, Inc. on June 2, 1987, for maintenance of the Stratus computer hardware and software. Monthly maintenance totals $4,433.

On July 28, 1987, the Lottery signed another agreement with Stratus Computer, Inc. regarding the Stratus software license. Under this contract, Stratus Computer, Inc. grants the Lottery a "nonexclusive, nontransferable license" to use the software of the Stratus computer. The proprietary rights and title of the software remain with Stratus Computer, Inc.

Training. The Montana Lottery also contracted with Scientific Games, Inc. on January 15, 1987, to provide

training and start-up assistance. This contract for $250,000 requires quarterly payments of $62,500 due July 24, 1987, October 24, 1987, January 24, 1988 and April 24, 1988.

Lottery Software. On February 25, 1987, the Lottery agreed to purchase the Instant Lottery System (ILS) software package for $840,400. This agreement provides the Lottery a "perpetual, non-exclusive, nontransferable license to use the software solely for the Lottery's own use". The contract allows the Lottery to make 36 monthly payments of $23,344.44 with no interest. The first payment was due June 1987.

Lottery Consultant. The Montana Lottery contracted with Gaming Dimensions, Inc. on February 27, 1987 for consultant services. These services included timetable development, fiscal and legislative recommendations, security system design, sales structure, and game implementation plans. These services were obtained due to the unexpected death of the consultant associated with Lottery Science, Inc. The contract terms provide for payment of services at $58.14 per hour, $100 per diem while in Helena, and reimbursement of travel expenses.

This contract was amended on June 1, 1987. The consultant's work was redefined to develop a test of the lottery system software, provide advice on start-up and adequacy of training, and prepare a report on the feasibility of an on-line game and regional lotteries. The amended contract provides for payment of the consultant at $58.14 per hour for 160 hours per month, $50 per diem while in Helena, and travel expense reimbursement. The contract expired on December 31, 1987.

Lottery Consultant. On November 30, 1986, the Montana Department of Commerce contracted with Lottery Science, Inc. for lottery consultant services. These services included organization structure, facility specifications, timetables, game implementation plans and other recommendations. These services were required due to the July 1, 1987 mandate for an operational lottery.

The contract, covering the period from November 30, 1986 to February 28, 1987, provided for payment of $58.14 per hour not to exceed $30,000, $100 per diem while in Helena, and travel expense reimbursement.

OTHER INFORMATION

MONTANA LOTTERY
SUMMARY OF FINANCIAL ACTIVITY BY PERCENTAGE
(UNAUDITED)
PERIODS ENDED SEPTEMBER 30 AND JUNE 30, 1987

COMMISSIONS - Section 23-5-1016(10), MCA provides retailers a 5% commission on tickets or chances sold. This commission on tickets sold to the retailer gives the retailer $25 per book of 500 tickets. The 5% commission of $392,852 and $263,229 for the periods ended September 30 and June 30, 1987 is based on gross lottery ticket sales of $7,857,051 and $5,264,578.

OPERATING EXPENSES - The Lottery, according to Section 23-5-1027(2), MCA, is allowed "up to 15% of gross revenue for operating expenses." Gross revenue includes net lottery ticket revenue and license fees. While retailer commissions, by law, are not considered an operating expense, interest expense is considered an operating expense for this purpose. The operating expense percentage for the periods ended September 30 and June 30, 1987, using the accrual basis of accounting, is as follows:

	September 30, 1987 (Unaudited)	June 30, 1987 (Unaudited)
Net lottery ticket revenue	$ 7,071,346	$ 4,738,120
License and permits	3,100	54,900
Total Gross Revenue	$ 7,074,446	$ 4,793,020
Operating expenses	$ 889,140	$ 1,117,917
Interest expense	17,645	12,416
Total Operating Expense	$ 906,785	$ 1,130,333
Operating expense percentage	12.82%	23.58%

The operating expense percentage for period ended June 30, 1987 reflects additional expenses related to the Lottery start-up. These expenses were funded by a general fund loan; which was paid on August 19, 1987.

Due to increased or decreased financial activity within a quarter, the operating expense percentage will fluctuate above or below the mandated 15% of gross revenue between quarters. However, operating expenses, as determined by the state budgeting process, by law, must be 15% or less of gross revenue over a year's time.

STATE SUPERINTENDENT OF PUBLIC INSTRUCTION TRANSFER - The funds transferred to the state Superintendent of Public Instruction, by law, are not based on a percentage of revenue. The distribution is based on a definition of net revenue. Net revenue is that part of all gross revenue not used for the payment of prizes, commissions and operating expenses. Net revenue for the periods

ended September 30 and June 30, 1987 is detailed below:

	September 30, 1987 (Unaudited)	June 30, 1987 (Unaudited)
Income before Operating Transfers	$ 2,590,582	$ 1,265,883
Residual Equity Transfer		(30,199)
Prior Period Adjustments	(2,032)	
Net Revenue	$ 2,588,550	$ 1,235,684

By combining the net revenue for periods ended September 30 and June 30, 1987, the initial transfer to the state Superintendent of Public Instruction is $3,824,234. The Lottery was exempted from making a transfer for the quarter ended June 30, 1987 until the general fund start-up loan had been paid.

PRIZES - Section 23-5-1027(1a) states "as near as possible to 45% of the money paid for tickets or chances must be paid out as prize money..."

Prize expense is recorded based on the predetermined prize structure percentage for each game. For the periods ended September 30 and June 30, 1987, the prize expense of $3,184,227 and $2,133,575 reflects 45.03% of the net lottery ticket revenue of $7,071,346 and $4,738,120, respectively.

When recording the prize expense, a corresponding liability for high-tier and Big Spin prizes is also recorded. The relationship between prize expense, prizes paid and the prize liability from June 24 through September 30, 1987 is illustrated below:

		Percent of Net Lottery Ticket Revenue
Prizes paid from June 24 - September 30, 1987	$3,448,593	29.20%
Prize liability as of September 30, 1987	1,869,209	15.83
Prize expense from June 24 - September 30, 1987	$5,317,802	45.03%

The prizes paid percentage of 29.20% for June 24 through September 30, 1987 is less than mandated 45% due to unclaimed prizes and not hitting the Big Spin jackpot. If these prizes are unclaimed within six months after game end, the remaining funds become available for prizes in other games.